the bid price which may occur during the period of redemption.

Assuming that the price bid for the property of the Debtor at the sale is its market value as found by the District Court, namely, $245,025. On the date of the sale the exercise of the right to redeem would not yield a profit. But if real estate values increase during the twelve or fifteen months of the right of redemption, the option to acquire the property may be of great value.

This Court will take judicial notice that this country is emerging from one of the severest depressions ever experienced; that the trend of values is now definitely upward and that an option for twelve to fifteen months to acquire property at a fixed price may be very valuable. If values do not increase, the option need not be exercised. However, if, as seems likely, the value of the property increases to an amount in excess of the bid price, whatever it may be, whether due to increased industrial activity, reduction in interest rates or some form of inflation, petitioners may be able to realize a substantial sum by exercising their option.

The District Court entirely overlooked these rights. There is nothing in the order of confirmation referring to them, and the language used by the District Court shows that it did not give to these rights even the remotest consideration. It made absolutely no finding as to their value. It did not value the right to bid at the sale of the property of the Debtor. It did not value the right to redeem the property from the sale. It did not value the possible increases in the value of the property which may occur during the period of redemption. This is clearly and fully shown by the order of confirmation of the District Court, Class 3 and Class 4, of claims (R. 13) and paragraphs 11 and 12 (R. 15).

No public sale was had, hence there could be no opportunity to bid and no beginning or ending of the year in which to redeem, and of course, no bid price at which the redemption could be made. How could such rights be valued, depending as they do on future events incapable of ascertainment until they occur? There is no standard by which to measure their value. Merely to state the rights shows that they are valuable.

B. The District Court erred in drawing, from the testimony as to, and its finding of, the fair market value of the property of the debtor, the erroneous inference that the vested property rights of petitioners are of no value.

Petitioners agree that they are bound by the findings of fact made by the District Judge. However, they are not bound by any erroneous inference from such findings even though such inference be couched in the language of a finding of fact.

Paragraph 11 of the order of confirmation (R. 15) contains the following finding of fact:

> "That the court having heard evidence and testimony on the value of the property of the Debtor finds: * * * that the Carlson Building Annex has a fair market value of $245,025, and that there is no equity over and above the $445,500, principal amount of Carlson Annex Bonds. * * *"

The above is a finding of fact and petitioners are bound by it. From this finding, the District Court drew an inference, couched as a finding of fact, which is a mere conclusion of the Court and which petitioners urge is not binding on the petitioners unless it follows logically from the previous finding. Such an inference is subject to re-

view by this Court as is any conclusion of law. The inference or conclusion is found in paragraph 12 of the order of confirmation (R. 15) and reads as follows:

> "That based on the above mentioned evidence and testimony *concerning the value of the Carlson Building Annex*, the court has appraised and does hereby appraise all claims allowed in Classes 3 and 4 to be of no value." (italics ours.)

Assuming for the purpose of the argument on this point that the word "claims," as used in the above quotation, includes the substantive rights in specific property which petitioners have by virtue of their mortgages and the statutes of Illinois, then it is clear that the finding is a mere conclusion and does not follow from any testimony as to the value of the property of the Debtor. Manifestly, evidence as to the present market value of the building and leasehold cannot be the basis for a conclusion as to the value of petitioners' right to redeem or option to acquire the property for a period of twelve months after a sale of the property at the price bid therefor.

The record is complete on this point and contains everything necessary to enable this Court to determine whether the inference follows from the finding of fact or whether it is merely the erroneous conclusion of the District Judge.

It is respectfully urged that whatever value there may be in the vested rights of petitioners heretofore specifically enumerated and which this Court appears to concede in its opinion that petitioners possess, it cannot be determined by looking solely at the evidence as to the present market value of the property covered by the mortgages. Obviously, the property may have a market value less than the first mortgage. Still, the right to redeem,

or option to acquire the property during a period of one year, not at its market value or at the amount due on the first mortgage, but at the amount bid at the sale, may be of great value. For example—suppose the property have a market value of $250,000, the first mortgage being $450,000, and a sale is held and the price bid is $200,000. An option to purchase at the bid price for one year is worth at least $50,000 based on present values. When conditions are improving and the tendency is perceptibly upward, such an option may become of great value. In its November, 1936 bulletin, the Federal Reserve System states that the index of industrial production has risen from 64% in 1932 to 108% in the third quarter of 1936.

A good illustration of the value of an option may be taken from the stock market. From June 1932 to June 1933, American Can Company stock rose from 30 to 95, American Telephone & Telegraph Company from 77 to 132 and Standard Oil of New Jersey from 19 to 38. An option on 1000 shares of each of these stocks at the market in June 1932 would in June 1933 have a value of $139,000.

If the conclusion drawn by the District Court is not logical, it is not binding on petitioners.

C. The District Court erred in not ascertaining the value of the security to petitioners' notes by the methods set forth in Section 57 (h) of the Bankruptcy Act.

The only explanation for the failure of the District Court to follow the plain directions of subdivision (b) (5) of Section 77B of the Bankruptcy Act in respect of the valuation of the security behind the notes of petitioners is that the District Court overlooked the fact that petitioners had any rights under the mortgages securing the notes. The language used by Congress is unmistakable. Towards the end of subdivision (b) (5) of Section 77B appears the following:

> "In the case of secured claims entitled to the provisions of clause (5) of this subdivision (b), the value of the security shall be determined in the manner provided in Section 57, clause (h) of this Act, and if the amount of such value shall be less than the amount of the claim, the excess may be classified as an unsecured claim."

Section 57 (h) of the Bankruptcy Act reads as follows:

> "The value of securities held by secured creditors shall be determined by converting the same into money according to *the terms of the agreement pursuant to which such securities were delivered to such creditors* or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance." (italics ours.)

Remington on Bankruptcy, Volume 7, Fourth Edition, Page 326, Paragraph 3153.32, discussing the treatment pro-

vided by Section 77B to be accorded non-assenting secured creditors, says:

> "The statute requires that their interests be adequately protected in one of the following ways: * * * (3) by appraisal and payment in cash of either the value of the interest or of the value of the securities allotted to such interest under the plan, this last to be at the option of the objecting creditors. *Any appraisal is to be worked out as provided for in Section 57 (h) of the Bankruptcy Act.*" (italics ours.)

A secured creditor is defined in Clause 23 of Section 1 of the Bankruptcy Act as a creditor who has security for his debt upon the property of the bankrupt. It is well established that the holder of a note secured by a mortgage on real property is within the class of secured creditors contemplated by Section 57 (h) of the Bankruptcy Act.

It is submitted that the record clearly shows that the District Court did not follow the law.

D. The District Court erred in confirming a plan which provided for a conveyance of debtor's property for a consideration not measurable in money and thereby depriving petitioners of their vested substantive rights in the property contrary to the Fifth Amendment.

Prior to the passage of the amendment to the Bankruptcy Act, petitioners became the owners of the substantive rights on specific property, heretofore enumerated, by virtue of the execution of their mortgages and of the Statutes of Illinois. All of these rights were wiped out without compensation by the plan of reorganization approved by the District Court in this case, and bestowed on a private corporation for private use. It is hard to conceive a more thorough deprivation of property.

The plan directed the Debtor to convey its property free of all claims to the 636 Church Street Building Corporation for a part of its stock and bond issues to be distributed among the holders of the first mortgage bonds of Debtor. In effect, the plan and the order of the District Court took the rights in the property which petitioners had and gave them to others without compensation.

There is no provision in the Bankruptcy Act, as amended, for such action. If there were, it would be clearly in violation of the Fifth Amendment.

If the District Court assumed that clause (c) of subdivision (b) (5) of Section 77B of the Bankruptcy Act contains the necessary authority, it overlooked the provision in subdivision (b) (5) providing that in case of secured claims, the value of the security shall be ascertained as provided in Section 57 (h) of the Bankruptcy Act. Under this section, petitioners would have been entitled to have a judicial sale with the accompanying right to bid thereat and to redeem.

Suppose, that the District Court had recognized that petitioners had the right to redeem and had placed a value upon it of, say, $10,000. Is there any provision in the law of the land which would permit any court to compel petitioners to surrender their right at that price to a private corporation for private use?

V.

General.

At the hearing on the petition for certiorari counsel for petitioner was asked by this Court if no plan of reorganization could be consummated without the consent of junior lienors. Inadvertently counsel stated that it could not, but what counsel intended to say was that no plan could be effectuated unless it preserved the rights of the junior lienors under the mortgages.

Petitioners concede that the plan of reorganization adopted in this case would be proper if it provided for a public sale of the property of the Debtor so that the junior lienors would be afforded the opportunity of bidding at the sale and of redeeming from the sale within one year from its date by paying the purchase price bid at the sale, with interest, in accordance with the Statutes of Illinois.

It is difficult to see why such a course was not adopted by the District Court. The owners of the first mortgage bonds would have had the opportunity of bidding for the property at such a public sale and if the same were acquired on their behalf they could, under the plan of reorganization, apply the first mortgage bonds to the purchase price. If the price bid were less than the amount of the first mortgage bonds, no cash outlay would be involved. If more, the excess would be applicable to the junior liens. Of course, the purchaser would acquire the property subject to the right of redemption of the junior lienors. At the expiration of the redemption period, if no redemption were made, the property would vest absolutely in the purchaser. If the property were acquired on behalf of the first mortgage bondholders and they desired to transfer it to the 636 Church Street Building Corpora-

tion for a consideration to be paid in stocks and bonds, they could do so with the same effect as is attempted to be done by the order of the District Court in this case.

Petitioners submit that this was the only course which the District Judge was authorized to pursue under the provisions of Section 77B, and that such a course is free from any constitutional objections on the part of junior lienors.

Petitioners recognize that in some instances a consummation of the plan of reorganization may be somewhat retarded by the requirement of the consent of junior lienors. However, if the junior lienors are unreasonable in their demands, it lies in the power of the District Court to confirm a plan without their consent by ordering a public sale of the property of the debtor, subject to the rights of the junior lienors, as heretofore pointed out. The plan of reorganization would be in no way affected except that for a period of one year after the date of sale the right of redemption would exist.

On the other hand such a requirement would eliminate any fear on the part of junior lienors of losing their rights and act as a check on unreasonable demands on the part of the holders of the first mortgage. This would be a wholesome and salutary condition and tend to make each party in interest adopt a fair attitude towards the others.

This court ought not to be influenced by the apparent great disparity in the market value of the property of the debtor as found by the District Judge and the amount of the first mortgage bonds. This is but an accident of this case. If the principle is applicable where the difference is large, it should govern in cases where the difference is slight and even in cases where the market value of the property is found by a court to be in excess of the

first mortgage bonds so that a surplus is applicable to the holders of the junior lien.

The Court will bear in mind that opinions as to the market value of property during a depression differ greatly. Witnesses are but human and their pessimism or optimism or unconscious bias frequently influence their testimony.

The so-called plan of reorganization in this case constitutes simply a transfer of the property of the Debtor to a stranger to the proceedings for a consideration distributed to the holders of the first mortgage bonds. In effect it is simply a foreclosure of the first mortgage lien, with the advantage to the holders of the first mortgage that it deprives junior lienholders of their right to a public sale, the opportunity to bid at the sale and their right to redeem. The unfairness of the plan becomes manifest when one visualizes the result in the light of the upward trend of the market and the possibility that during the period of redemption allowed by the Statutes of Illinois the market value of the property may greatly increase. These advantages conferred by law on the junior lienors were taken from them and conferred on the holders of the first mortgage bonds and on the 636 Church Street Building Corporation.

Petitioners respectfully further urge that once it is admitted that property has been taken without due process, there is never any question of the value of the property. The Fifth Amendment directs that no one shall be deprived of life, liberty or property without due process of law. The words are without limitation.

It would be a strange doctrine that would prevent one who has been deprived of his home or farm by a statute contrary to the Fifth Amendment from questioning the

constitutionality of the statute because his home was a hovel and of no value in the opinion of real estate men, or that his farm consisted of swamp land which could not yield a crop in excess of the value of the labor put upon it.

Petitioners are aware of the doctrine exemplified by the authorities cited in the opinion of this Court, that one may not question the constitutionality of a law which does not affect him directly. Of course, one may not question a law which deprives others of property. In the instant case, however, petitioners have been deprived of their vested, substantive rights in specific property and are, therefore, clearly within the class who may question the constitutionality of the law or of the judicial act under which such deprivation has been effected.

VI.

Public Importance of Issues.

Effect on Mortgages:

It took many years to develop an investment market for real estate mortgages. At first, property holders were reluctant to place mortgages on their property and much time elapsed before even first mortgages came into favor. Knowledge of the advantages in the purchase of a home or other property, with a small initial payment, spread slowly. Dealings in second mortgages were regarded with still less favor. Prejudice in this field, too, slowly decreased and in recent years it was generally recognized that the increase in credit made possible by the issuance of notes and bonds secured by first and junior mortgages had a stimulating effect on industry. Particularly is this true in the building industry.

Subsidiary financing (that is, the money provided for an enterprise to supplement that provided through the sale of first mortgage securities) has been growing in importance. Prior to the depression, in 1929, it had become a recognized factor in finance and was regarded as a useful and necessary source for the supply of part of the capital required in the financing of industrial enterprises, the erection of buildings and the sale of homes. The money thus furnished contributed to the general prosperity.

If unhampered, junior lien securities will become increasingly important in financing new industries, the expansion of existing plants, the replacement of obsolete and worn-out machinery and particularly the revival of the building industry, all of which must come if this country is to recover completely from the depression.

As dealings in mortgage securities increased, the rights of mortgagees became well established. Among the rights possessed by mortgagees which made mortgages desirable investments are the following:

(1) The right to retain the lien of the mortgage, first or junior, until the debt is paid or until the lien is terminated by a judicial public sale in accordance with the Statutes of the state in which the property is located.

(2) The right to bid at the sale.

(3) In the case of a junior lien, the right to redeem the property from the purchaser at the sale if the purchaser should be the prior lienor or a stranger.

It is universally believed that the above rights are protected by the Fifth Amendment to the Constitution and that no mortgagee can be deprived of any of these rights by any act of the mortgagor or because of any financial diffi-

culties the mortgagor might encounter. Millions of dollars have been invested in mortgage securities, both first and junior, in reliance on this belief.

The right of redemption, developed originally to prevent the wiping out of the equity as the result of a temporary collapse of values due to a temporary financial disaster, is greatly valued by the junior lienor as it affords him the same protection.

Under the laws of Illinois this right continues for one year or fifteen months, and the price at which redemption can be made is fixed by statute at the price bid at the sale. These rights protect the junior lienholder from total loss should he be unable to raise sufficient money on short notice.

The order of the District Court in this case is founded on the assumption that these rights may be wiped out in a proceeding under Section 77B of the Bankruptcy Act. Under such assumptions the District Court may, in any such proceeding, arrive at the value of the property covered by mortgages by receiving the testimony of men engaged in the real estate business as to its then market value, and when in such case the court finds that the then market value of the property is less than the prior charges thereon, the court may wipe out all liens subsequent to such prior charges and all rights accruing under them. Thus, it may happen even in the case of a first mortgage that the court may find that the prior charges consisting of the expenses of the proceedings, taxes, etc., are greater in amount than the then market value of the property and as a result without giving any of the mortgagees, first or junior, an opportunity to hold a public sale of the property subject to their mortgages, or to bid at such sale, or to redeem therefrom, the court may order such property conveyed to a stranger upon its paying the amount of the prior charges.

If a District Court has such power in a proceeding under Section 77B, it would logically follow that it would also have the authority, in case it found that the property was worth more than the prior charges, to direct the conveyance of the property upon the payment of the excess to the lienholders.

Apparently in all such instances it would be of no effect for the holders of the senior or junior liens to plead that in their opinion the property was worth more than the value placed upon it by the Court, and that they desired to avail themselves of the right to acquire the property at an amount equal to, or greater than, the value found by the Court, or that such lienors desired the property sold at a judicial public sale and desired the right to bid thereat, and if unsuccessful, to redeem within the statutory period.

This is a new and dangerous doctrine, heretofore unheard of in the law of mortgages. It implies a power that ought not to be lodged in the District Court. It is inimical to that freedom of contract which is so necessary to industrial prosperity.

Nor can it be said that such power in the hands of the District Court will facilitate the consummation of plans of reorganization in cases where the necessary consents cannot be obtained. In all proper cases, property subject to non-consenting lienors may be ordered sold at public auction subject to the right of the lienors to bid and to redeem under the Illinois Statutes. The delay due to a public sale and the inconvenience of having the property subject to redemption are trifling in comparison to the confusion created by the introduction of a new doctrine in the law of mortgages.

Effect on 77 B Proceedings:

Congress passed the amendment to the Bankruptcy Act because it believed that a speedier and less expensive proceeding than the Equity Receivership would facilitate recovery from the depression and be permanently useful. It would appear, therefore, that proceedings thereunder should be encouraged. General industry is benefited whenever corporations or properties in financial difficulties are relieved, taken out of the hands of the courts and given their proper place in industry under private management.

Obviously the holders of equities will be reluctant to file proceedings if by filing the same they run the risk of losing their equity because of a determination by the District Judge, based on opinion evidence, that the present market value of the property involved is less than the amount of the first mortgage. It will be impossible to procure the cooperation of junior lienholders if by coming into the proceedings they risk the loss of vested rights long regarded as necessary for the protection of their investment.

A majority of the proceedings under the amendment are filed voluntarily. In many instances the debtors have committed no act of bankruptcy and involuntary proceedings could not be filed under the law. Hence, it is clear that if the order of confirmation entered in this case is upheld, the number of proceedings filed under the amendment will be greatly reduced.

VII.

Conclusion.

It is respectfully urged that out of regard for the important issues involved affecting, not only the parties to this case but the large number of public and private institutions and individual investors in real estate mortgage securities, this petition for rehearing be granted; that upon further consideration, the order of this Court of November 9th, 1936, be vacated or modified, and that the parties be given another opportunity to argue and present this cause; and that on final hearing the order of the Circuit Court of Appeals for the Seventh Circuit denying petitioners leave to appeal from the order of the District Court be reversed.

Respectfully submitted,

THEODORE E. REIN,
ISAAC M. MILLS,
Counsel for Petitioners.

Certificate of Counsel.

We, Theodore E. Rein and Isaac M. Mills, counsel for the above named petitioners, Emil Rosenthal and B. K. Goodman, do hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay.

THEODORE E. REIN,
ISAAC M. MILLS,
Counsel for Petitioners.